UNITED MALAYAN BANKING CORPORATION BHD.

v.

SIN KIM LEE & CO. SDN. BHD. & ORS.

HIGH COURT MALAYA, KUALA LUMPUR
DATUK K.L. REKHRAJ JC
[CIVIL SUIT NO: C2-23-3056-86]
6 MAY 1996

BANKING & FINANCE: *Guarantee - Continuing guarantee by company directors to secure bank facilities - Meaning of term 'credit' - Whether credit given by bank - Intended consideration - To allow time to pay.*

CONTRACT: *Guarantee - Continuing guarantee - Consideration - Sufficiency - Past consideration - Element of forbearance - Whether guarantors liable - Whether liability absolute.*

BANKING & FINANCE: *Bank and banking business - 'At sight draft' - 'Confirmed irrevocable documentary credit' - Seller and confirming bank - Documents - Whether regular on the face of it - Whether documents presented conform with requirements of credit - Whether confirming bank and issuing bank responsible to each other or buyer for authenticity of documents - Whether bank under contractual obligation to honour draft.*

BANKING & FINANCE: *Securities for advances - Continuing guarantee by company directors to secure bank facilities - Fraud by co-directors - Whether bank guilty of neglect - Whether bank disentitled from recovering under guarantee - Whether directors liable for fraud of co-directors.*

WORDS & PHRASES: *'Credit'.*

The defendant company ('the first defendant') had applied and obtained various banking facilities ('the facility') from the plaintiff bank ('the plaintiff') in 1975. The facility was granted subject to, *inter alia*, the condition that it was guaranteed by all of the first defendant's directors jointly and severally in their personal capacities. To this end, the 2nd, 3rd, 4th, and 5th defendants had, as directors of the first defendant, executed a letter of guarantee ('the guarantee') in favour of the plaintiff, the terms of which were, *inter alia*, that: (i) the guarantee was a continuing guarantee and/or indemnity; (ii) the 2nd, 3rd, 4th, and 5th defendants shall be constituted or become the principal debtors and shall be solely liable; and (iii) the guarantee shall be one of indemnity.

Eventually, a sum of RM511,864.72 ('the said sum') became due and payable by the first defendant to the plaintiff - under five 'at sight drafts' which, at the first defendant's request, were issued by the plaintiff and made payable

in favour of a Singapore company ('the Singapore company'). Consequently, the plaintiff made a demand for the said sum on all the defendants.

Subsequently, the 4th and 5th defendants discovered that the 2nd and 3rd defendants were also directors of the Singapore company, and that they had produced fictitious delivery orders - in purported confirmation of receipt of goods by the first defendant - before the plaintiff's corresponding bank in Singapore ('the Singapore bank') for the purpose of cashing the five 'at sight drafts'. In respect of this, the 2nd and 3rd defendants had been charged and convicted in Singapore. Consequently, the 4th and 5th defendants refused to repay the plaintiff.

The sole issue before the Court was whether the 1st, 4th, and 5th defendants were liable, under the terms of the guarantee, for the said sum which was reimbursed by the plaintiff to the Singapore bank consequent upon the 2nd and 3rd defendants' fraudulent act of which both the plaintiff and the Singapore bank had no knowledge at the material time.

Held:

[1] The term 'credit' means "the time which a creditor will allow his debtor in which to pay, or the total amount which he will permit to borrow or to owe." Therefore, the defendants' contention - that no credit had been given by the plaintiff since the execution of the guarantee - was erroneous. The intended consideration was to allow the first defendant time to pay. This was evident from the words of the guarantee, ie, "In consideration of your agreeing ... to continue/open an account current with and to give credit to ..."

[2] A continuing guarantee by itself, incorporates sufficient consideration and the Court will reject any argument of past consideration. In the instant case, the guarantee was executed with the intention of an element of forbearance; thus, there was good and sufficient consideration for the guarantee. The liability of the defendants as guarantors was absolute.

[3] It is trite law that the seller of goods and the confirming bank deal only with documents and not in goods. If on the face, the documents, as presented by the seller to the confirming bank, conform with the requirements of the credit as notified, then the bank is under a contractual obligation to the seller to honour the drafts. The whole commercial purpose for which the system of 'confirmed irrevocable documentary credit' has been developed in international trade is to give the seller an assured right to be paid before he parts with the goods. It is settled that confirming banks and issuing banks assume no liability or responsibility to one another or to buyers for the form, sufficiency, accuracy, genuineness, falsification, or legal effect of any documents.

[4] The plaintiff was not guilty, either directly or indirectly, of any neglect of duty that would disentitle it from recovering the said sum from the defendants. Being directors of the first defendant, the 4th and 5th defendants had failed to foresee the possibility of the fraudulent acts of the 2nd and 3rd defendants who were their co-directors. Thus, the 4th and 5th defendants were bound by the term of the guarantee which read, "The guarantors' liability shall not be nullified … for any reasons whatsoever."

[5] The 2nd and 3rd defendants could not be absolved of their liabilities simply because they were inactive directors of the first defendant; they ought to be held responsible for the dishonesty of their co-directors.

[Plaintiff's claim allowed]

Cases referred to:

First National Bank of Chicago v. Tan Lai Wah [1981] 2 MLJ 100 ***(refd)***
Gian Singh & Co. v. Banque de Indochine [1974] 2 All ER 754 ***(foll)***
Ulster Bank, The v. Synnott [1871] IR 595 ***(refd)***
Woods v. Thiedeman 1 H & C 472 ***(foll)***
Basse & Selve & Bank of Australia LT 618 ***(foll)***
Development & Commercial Bank v. Syarikat Farmco Sdn. Bhd. & Ors. [1988] 3 MLJ 277 ***(cit)***
The Chartered Bank v. Cheviot Industries (M) Sdn. Bhd. & Another [1988] 2 CLJ 859 ***(cit)***
Perwira Habib Bank Malaysia Bhd v. MET Sdn. Bhd. & 3 Ors. [1988] 2 CLJ 480 ***(cit)***
Shell Marketing Co. of Borneo Ltd. v. Tan Sri Datuk Wee Boon Ping [1990] 1 CLJ 564 ***(cit)***
Perwira Habib Bank Malaysia Bhd. v. Fast Travel (M) Sdn. Bhd. & Ors. [1988] 3 MLJ 210 ***(cit)***
Public Bank Berhad v. Tradikon Sdn. Bhd. & 4 Ors. [1989] CLJ 1111 ***(cit)***
Malayan Banking Bhd v. Senorita Holdings Sdn. Bhd. & Ors. [1991] 3 CLJ 2888 ***(cit)***
Perwira Habib Bank (M) Bank Bhd. v. Saiyo Sdn. Bhd. & 2 Ors. [1991] 3 CLJ 1849 ***(cit)***
Perwira Habib Bank (M) Bank Bhd. v. Sri Yazmin Sdn. Bhd. & 3 Ors. [1991] 1 CLJ ***(cit)***
Heng Cheng Swee v. Bangkok Bank Ltd. [1976] 1 MLJ 267 ***(cit)***

Other sources referred to:

Osborne Concise Law Dictionary, 7th Edn, p. 102

For the plaintiff - Bhag Singh (Stefeny David with him); M/s. Annuar & Assoc
For the 1st, 4th & 5th defendants - Murthi; M/s. Murthi & Partners

JUDGMENT

KL Rekhraj JC:

Facts

The first-named defendant (hereinafter called "the company") made an application in the year 1975 to the plaintiff bank for various banking facilities; and the bank by its letter dated 1 July 1975, approved the facility on an annual basis subject to the following conditions:

(a) the account was to be actively and satisfactorily maintained at all times;

(b) the facility was to be guaranteed by **all** the company's directors jointly and severally in their personal capacity,

(c) the bank reserved for itself the right to renew the facility annually reviewing periodically and to be made repayable on demand.

The company confirmed the acceptance of the conditions by endorsing on the duplicate copy of the letter of acceptance; under the hand of the company's authorised signatories.

From the agreed bundle of documents and the agreed facts it is noted:

(1) the company had from time to time produced to the plaintiff bank the required resolutions; **the first of which** was dated **7 April 1975,** resolving, the company do obtain from the plaintiff bank a banking facility upon such terms and conditions as may be arranged by the said bank.

(2) The first resolution was followed by a circular resolution called the second resolution dated 12 September 1978 which resolved:

That the company do obtain from UMBC Corporation Bhd the following revised banking facilities upon terms and conditions as may be agreed to with the said bank:

Overdraft	RM 30,000
Letters of credit	RM200,000
Trust-receipts	RM125,000
	RM355,000

and that the facility be guaranteed jointly and severally by all the directors for the time being of the company in their personal capacity.

(Note) – at this period of time there were seven directors, all of whom signed the circular resolution.

The second resolution was similarly followed by a third resolution dated 20 March 1979 which resolved:

(a) That following the resignation of three of the seven directors, the bank be requested to cancel the personal guarantees of resigning directors and the revised banking facility be now guaranteed jointly and severally by all the directors for the time being of the company in their personal capacities.

(b) That the banking account be now operated by any two of the four remaining directors.

The bank also obtained from the second, third, fourth and fifth named defendants (hereinafter called "the guarantors") a letter of guarantee dated 28 May 1985, which letter of guarantee begins with the usual magic word, "In consideration of your agreeing at my/our (joint and several request **to continue/** open an **account current with and to give credit** to Sin Kim Lee & Co. Sdn. Bhd. the first named defendant - (hereinafter called the customers). I/ We hereby (jointly and severally) agree **to guarantee** and/or **indemnify** you as follows:

Clause 1 – We will pay to you on demand ... all money **which now is** or may during the continuance of this agreement be owing to you from the customers or remain unpaid...

Clause 4 – of the said guarantee reads, "This guarantee and indemnity **shall be a continuing guarantee and/or indemnity."**

By Clause 6– the guarantors had bound themselves to the effect; "that a **certificate in writing** signed by the manager or accountant or other duly authorised officer or solicitor of the bank shall be accepted by us as **conclusive evidence** of the amount due and owing to the bank from the customer.

By Clause 7– The **guarantors liability shall not be nullified... for any reasons whatsoever (whether known to me/ us or not) I/we shall be constituted** or become the **principal debtors** and **shall be solely liable for the payment of the moneys**; ... and this agreement may in fact or at law shall be **one of indemnity** and not of guarantee ... and **notwithstanding the customers have no power at law or authority to borrow, ..., or** that **for any other reason it may be or become impossible to proceed against the customer herein.**

A sum of RM511,864.72 came to be due and payable by the company; under five "at sight drafts" issued by the bank in August 1984 at the request of the company, and made payable in favour of M/s Kerk Heng Pte. Ltd. Singapore; upon their delivering goods to the company, and which delivery was duly verified by the company by countersigning acceptance of the delivery orders under the hand of the authorised signatories.

On **5 November 1985,** the plaintiff made a demand on the company and the guarantors, for the then outstanding sum of RM511,864.72, to which letter of demand, the company replied admitting the debt but seeking indulgence of the plaintiff to permit settlement by monthly instalments of RM20,000 commencing December 1985; but only to default.

A year or so later the fourth and fifth named defendants, the guarantors/ directors of the first named defendant company discovered that the second and third named defendants were also the directors of the Singapore company, - and as such had produced to the bank fictitious delivery orders in confirmation of receipt of goods by the company when encashing the drafts. That this act of fraud by the second and third named defendants caused a loss to the banks and to the company. A police report was lodged as a result of which both the second and third named defendants were charged and convicted in Singapore for dishonestly inducing the plaintiff's corresponding bank in Singapore to pay or release the sums to M/s. Kerk Heng Pte Ltd – beneficiaries to the "At Sight" Draft.

The fourth and fifth named defendants now refuse to make payments on **two grounds:**

(1) That the guarantee that was executed by them was premised "to continue/ open an account current with and **to give credit**" and since no "further credit" was given after the guarantee was executed, the condition contingent was not met, and the guarantors are thus accordingly "relieved from all liability".

(2) That the Singapore bank was induced to pay the sums payable under the irrevocable letters of credit by a conspiracy between the second and third named defendants and therefore the plaintiff bank must proceed through their corresponding bank against the beneficiaries for the recovery in law or in fact and not against the defendants.

It is however an admitted fact by the parties through their Counsels that neither the Singapore bank, nor the plaintiff bank were ever aware of any such conspiracy or dishonesty or was there any irregularity or discrepancy on the face of the documents, before or at the time of such payments made to the beneficiary.

With these facts in perspective, I directed the Counsels to address the Court only on the one issue as to:

(a) "whether under the terms of the guarantee, the 4th and 5th named guarantors are liable for money reimbursed, as paid by the plaintiff to the Singapore bank under the five letters of credit (upon an act of fraud perpetrated in Singapore) by the second and third named defendants on the Singapore bank; and as a result of which both the second and third named defendants were committed to prison in Singapore, the criminal act of which the **banks had no knowledge at all; at the material time prior to payments.**

(b) The parties' Counsels further agreed that the answer to the directed question will determine the outcome of these proceedings; and that there shall be no other issues to be decided by the Court.

(c) That this being the only issue – a point of law, *viva voce* evidence was dispensed with by consent, and the Enclosure marked (71) being agreed bundle of documents, was to be read "as agreed bundle of documents and as agreed facts."

(d) Whether the first defendant (the company) is now liable to pay under the plaintiff's claim.

After reading the Counsel's written submission and in light of the agreed and narrowed issue as addressed to the Court on the two points, I now proceed to decide:

(a) **On the first ground:** as to whether the guarantors are relieved from all liability under their guarantees, the defendants' Counsel's contention that **no credit** was given by the plaintiff since the execution of the guarantee is erroneous; because the Counsel has proceeded to define the words – **"to give credit"** to mean **advances,** but according to *Osborne Concise Law Dictionary* Seventh Edition at p. 102 "credit" is said to mean, the time which a creditor will allow his debtor to pay or the total amount which he will permit to the borrower or to owe; and therefore upon reading the guarantee as a whole in totality; the **intended consideration was to allow the customer** of the bank **time to pay** and this is evident from the opening words of the guarantee "In consideration of ... request **to continue** ... and to **give credit** to M/s. Sin Kim Lee & Co. Sdn. Bhd.; and in paras. (b) and (c);

(b) we will **pay you on demand** ... all money **which now is** or may during the continuance of this agreement be owing to you from the customer ... or remain unpaid... ;

(c) that this guarantee and indemnity shall be a **continuing guarantee** and/or indemnity ... .

In support of this argument there are numerous authorities which have decided that where the guarantee was to be a **continuing guarantee;** that by itself incorporated sufficient consideration and the Court will reject the argument, if any, of past consideration.

In the case of *First National Bank of Chicago v. Tan Lai Wah* the guarantee was signed much later after the entire loan had been disbursed, and the Singapore Court of Appeal in rejecting the argument of the absence of consideration said:

> This guarantee is no exception as it contains the clause [In consideration of ... at our request making or continuing advances or otherwise giving credit ...] The expression "continuing advances" and "affording banking facilities" are quite sufficient ... to meet the circumstances under which the guarantee ... was given and we accordingly reject ... the plea of no consideration.

Reading the guarantee as executed it was also envisaged with the intention of an element of forbearance and I am satisfied that there is good and sufficient consideration for the guarantee; and to that extent the plea that the guarantors are relieved of their liability must fail; instead their liability is to be made absolute.

In answering the second question.

It is trite law that the seller of goods and the confirming bank deal only with documents and not in goods. If on the face of the documents as presented to the confirming bank by the seller, conform with the requirements of the credit as notified, the bank is under a contractual obligation to the seller to honour the drafts. The whole commercial purpose for which the system of confirmed irrevocable documentary credit has been developed in international trade is to give the seller an assured right to be paid before he parts with control of the goods and does not permit any dispute with the buyer.

In the well illustrated Privy Council case of *Gian Singh & Co. v. Banque de' Indochine* [1974] 2 AER 754, it was settled in clear law that the confirming banks and the issuing banks assume **no liability** or **responsibility** to one another or **to the buyer** for the form, sufficiency, accuracy, genuineness, falsification or legal effect of any documents. In *Gian Singh's* case the customer of the bank was **held liable to reimburse the issuing bank** for honouring a documentary credit on presentation of an apparently conforming document which was an ingenious forgery, a fact that the bank had not been negligent in failing to detect on examination of the documents.

Again in the case of *The Ulster Bank v. Synnott* [1871] LR 595, the defendant, a merchant instructed his banker to accept the drafts on being handed a clean bill of lading of a cargo consigned to the latter a bill of lading, professing to answer the description in the instructions, was handed to the banker, who accepted the drafts, and it later turning out that the bill of lading

was forged, paid the amount of acceptances and the Court there held that the banker was not bound to see that the bill of lading was genuine, but only that it was regular on the face of it.

The Vice Chancellor at p. 606 said:

> I must, therefore now proceed to deal with the matter in dispute - namely, whether the loss which has been occasioned by the forgeries ... is to fall upon the plaintiffs or the defendant. Both parties are entirely innocent, and one or other must suffer for Linden's Crime. Two questions must be answered; the first - what was the duty undertaken by the bank? The second, did the bank fail to discharge that duty? The letters of instructions written by the defendants to the plaintiffs, and by them, in effect transmitted to the London & Westminster Bank, appear to have been of an ordinary character, requesting the plaintiffs to instruct their London agents to accept the Bills of Linden on being handed the shipping documents of the specified cargoes.

Upon those instructions, the bank's duty was to pay.

In answering the second question, his Lordship referred to the case of *Woods v. Thiedeman* 1 H&C 472:

> that the bank was not bound to see to the genuineness of the bills of lading, but only to this, that the documents presented to them were on the face of them ordinary bills of lading, professing to represent the cargoes as specified ... . The defendant's letters of instructions assumed that there was such a cargo and on the presentation of which bills, the bank was to accept or pay. It was the duty of the defendants to satisfy themselves that these facts were so.

The bank, certainly was not answerable for his having been deceived. In proceeding further his Lordship said:

> **If** an action was brought against the plaintiff by the defendant, grounded on this supposed negligence, I cannot see how he could recover as damages the money lost by reason of Linden's forgery. Such damages would in my opinion be altogether conjectural and remote. If so, such negligence even if satisfied, could not form a defence to a suit by the bank either at law or in equity, to recover the money paid for the defendant's use. If there were such documents as would satisfy the defendant's instructions, the bank was justified in accepting them. They did profess to be such, I can have no doubts.

In the case of *Basse & Selve & Bank of Australia* LT. p. 618, where the bank gave credit against the production of documents – certificates of analysis - under a fraudulent misrepresentation; and subsequently the beneficiary of the bill was convicted of obtaining that money by fraudulent misrepresentation. The Court held that the certificate on its face was regular and came within the meaning of the mandate; and there was no duty on the bank to see to the samplings. The bank was entitled to assume that the analyst had acted skilfully in making the analysis. The facts of that case were:

Very shortly after parting with the money, the defendants in Sydney discovered that Oppenheimer **(the beneficiary of the drafts)** had been guilty of a trick and subsequently was prosecuted for obtaining the £800 from the defendants by fraudulent misrepresentation and upon being convicted, was sentenced to 18 months imprisonment. The plaintiffs, who had paid £800 received nothing for their money, and they sought to make the defendants responsible for the loss, on the ground that in paying the money to Oppenheimer in exchange for the false certificate, they failed or neglected to observe the terms of their mandate. The defendants resisted the plaintiffs' claim, and the Court held, that the defendants' duty was only to see that the documents as presented purported on their face to be the documents described in the mandate. It was no part of their duty to verify the genuineness of the documents; the duty was not cast upon them of making inquiries at the office of the shipping agents as to whether the goods had in truth been received on board; nor were they to examine the contents of the packages to see whether they were right. *The plaintiffs' mandate amounted in business a representation to the defendants that upon all such matters they might rely on Oppenheimer, and the legal effect of such representation is now to preclude the plaintiffs from questioning the validity of any apparently regular documents which Oppenheimer might tender.* That it was no part of the bank's duty to see to the samplings. The bank was entitled to assume that it was so and the certificate was on the face being regular within the mandate to the bank; the bank acted carefully and properly; and proceeded to dismiss the plaintiff's claim against the bank.

Now, after a careful consideration of all the authorities, more particularly *Gian Singh's* case and the last two; I conclude and hold that the plaintiff has not either directly or indirectly been guilty of any neglect of duty as to disentitle it to recover from the defendants the money it had paid to the first defendant's use in taking up their acceptance at the request of the first defendant's authorised signatories. This loss to the defendants has occurred without the default of the plaintiff - who being totally innocent, but as a result of a conspiracy of the second and third defendants as joint and several guarantors and as the chairman and the managing director respectively of the first defendant. The fourth and fifth defendants as director had failed to foresee that possibility of the fraudulent acts of their co-directors and as such are bound by clause 7 of their guarantee which reads, "The guarantors' liability shall **not be nullified ... for any reasons whatsoever."**

Therefore, the loss must be borne by the defendants, at whose instance and whose benefit the plaintiff acted and the fourth and fifth defendants cannot be absolved of their innocence just because they were inactive directors of the company and thus ought to be made responsible for the dishonesty of their co-directors. I therefore give judgment to the plaintiff against the defendants with interest and costs.

Reported by Gan Peng Chiang